CALIFORNIA DEPARTMENT OF FOOD AND AGRICULTURE

Dairy Marketing Branch

RECORD CLASS 1 PRICES

How high are the May 2004 milk prices?

The California Department of Food and Agriculture sets minimum prices that dairy processors must pay for milk received from dairy farmers. The minimum price for fluid milk (Class 1 price) will set two records in May 2004:

- **Highest Class 1 prices** on record; and
- **Largest Class 1 price increase** on record.

Highest Class 1 prices. At $21.27 and $21.54 per hundredweight, respectively for Northern and Southern California, the May prices exceed the old record set in February 1999 of $19.78 and $20.05 per hundredweight. On a per gallon basis, these price levels translate to raw product costs of:

Type	Fat	SNF	Northern CA Price per gallon	Southern CA Price per gallon
Whole Milk	3.5%	8.7%	$1.83	$1.85
Reduced Fat	2.0%	10%	$1.66	$1.68
Lowfat	1.0%	11%	$1.56	$1.58
Skim/Nonfat	0.1%	9.0%	$1.17	$1.20

Largest Class 1 price increase. The record price increase of $5.49 per hundredweight from April to May 2004 exceeds the old record increase of $4.88 per hundredweight from September to October 1999. On a per gallon basis, the increase translates to:

Type	Price Increase per gallon*
Whole Milk	+47.2¢
Reduced Fat	+51.6¢
Lowfat	+55.2¢
Skim/Nonfat	+46.7¢

* Actual retail price changes may differ.

What is causing record milk prices?

In stark contrast to the situation experienced a year ago, farm milk prices have surged in recent months. Wholesale butter and cheese markets remain somewhat volatile, experiencing large day-to-day price changes. Nonetheless, CME butter and cheese prices have been trending sharply upward, increasing by over 96¢ per pound for butter and 82¢ per pound for cheese since December 31, 2003.

Unlike high milk prices in previous years, there does not appear to be any one reason that would explain the upward price movements in wholesale dairy markets. We offer the following abbreviated list of factors that may be contributing to the extraordinary price levels:

- Milk production is not increasing and is expected to be "soft" for several months if not the rest of 2004. Milk production has been lower in each of the past 6 months relative to the milk production levels of last year.
- The Canadian border is closed blocking the normal importation of new dairy cows.
- Dairy cow numbers are down across the U.S.
- Milk production per cow is lower because:
    - Higher milk prices encourage dairy farmers to keep older, less production cows; and
    - Feed quality is poor in some parts of the country.
- Sales of dairy products, which have been sluggish for the past two years, are expected to increase significantly this year, particularly for cheese.
- Lenders may be reluctant to finance dairy expansions until there is some recovery of equity lost during the record low prices of 2002 and 2003.

While there is no dispute that prices are strong now, not everyone expects prices to remain that way for the rest of the year. Some of the reasons prices may retreat from recent highs are:

- Commercial use of dairy products is experiencing only moderate growth.
- The economic recovery remains unsettled and does not show a clear direction.
- Commercial stocks of dairy products have been reduced but not remarkably.
- Certain factors are not expected to deviate much from previous years:
    - Number of dairy farms going out of business;
    - Slaughter prices for older, less production cows; and
    - Size expansion of existing dairy farms.
- Dairy product markets are ***expected*** to be tight later in the year, and milk production is ***expected*** to be lower than normal for the remainder of the year. However, those expectations are only forecasts, and those events may not actually materialize.